No. 22,182

United States Court of Appeals

For the Ninth Circuit

SHELDON F. SACKETT, and KVAN, INC., a Washington corporation,

Appellants,

vs.

J. FRANK BEAMAN, and FIDELITY AND DEPOSIT COMPANY OF MARYLAND, a corporation,

Appellees.

BRIEF FOR APPELLANTS

NATHAN S. SMITH,
JAMES G. SEELY, JR.,
220 Bush Street - Suite 976,
San Francisco, California 94104,
Attorneys for Appellants.

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JURISDICTIONAL STATEMENT

This is an appeal from a judgment of dismissal with prejudice entered on August 3, 1967, by the United States District Court for the Northern District of California, dismissing the complaint of plaintiffs, Sheldon F. Sackett and KVAN, Inc., a Washington corporation (hereinafter referred to collectively as "Sackett"). The District Court action was brought by Sackett for declaratory relief with respect to a contract for the sale of stock and promissory notes given pursuant thereto which were alleged to be unlawful and void because made and given in violation of the

Securities Act of 1933 and the Securities Exchange Act of 1934. The action also sought a preliminary and final injunction restraining the enforcement of a State Court judgment entered against Sackett with respect to said contract and said notes. The District Court's jurisdiction was invoked under 15 U.S.C. 77v, 15 U.S.C. 78aa and 28 U.S.C. 2201. Sackett filed his notice of appeal on August 4, 1967 in the District Court and this court's jurisdiction rests on 28 U.S.C. 1291.

STATEMENT OF THE CASE

1. Factual background

On November 8, 1961, Beaman sold Sackett 2,500 shares of the common stock of News Publishing Company, a Virginia corporation publishing a weekly newspaper in Portsmouth, Virginia. During the negotiations prior to the sale Beaman brought to San Francisco and showed Sackett a profit and loss statement of the company for the period ending August 24, 1961, which showed a net profit of $5,285.00. Sackett paid $1,000.00 down and gave notes for the remainder of the purchase price of approximately $25,000.00.

Shortly thereafter, in December of 1961, Sackett received a copy of a financial statement of the company prepared by a firm of certified public accountants which showed net losses of $37,612.34 as of October 31, 1961. Upon receipt of said statement, Sackett orally disaffirmed his contract with Beaman and, on December 29, 1961, sent Beaman a written notice of rescission.

2. Beaman's State suit

On January 24, 1962, Beaman filed suit against Sackett in the Superior Court of the State of California for the City and County of San Francisco, Action No. 518296. In that action, Beaman sought to recover approximately $10,000.00, the amount then due on Sackett's notes. Sackett defended on the basis of his rescission and cross-complained for restitution of his $1,000.00.[1] On May 5, 1965, Beaman obtained judgment against Sackett for $10,591.50 plus interest and attorneys' fees. Sackett appealed, and execution of judgment was stayed by virtue of an appeal bond in the sum of $20,500.00 which Sackett obtained from Fidelity and Deposit Company of Maryland. To do this, Sackett on or about June 22, 1965, assigned to Fidelity, as security, various savings and loan association certificates of deposit totaling $20,500.00. The California Court of Appeal affirmed the decision of the lower court. The decision became final on May 22, 1967 when the California Supreme Court denied Sackett's petition for a hearing. In August, 1967, Fidelity paid Beaman $18,733.71 in partial satisfaction of the judgment against Sackett.

3. The Federal suit

Sackett filed the suit below on April 20, 1967, seeking a declaration that the stock sale contract was void for alleged violations by Beaman of the Securities Act of 1933 and the Securities Exchange Act of 1934,

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[1]The validity of the sale under Federal securities laws was not litigated in the State action.

specifically Sections 77q and 78j of Title 28, U.S.C. and Securities and Exchange Commission Rule 10b-5. Sackett also sought an injunction restraining enforcement of the State court judgment pending determination of the Federal suit. Sackett's motion for preliminary injunction was denied on May 22, 1967. Sackett moved in this court for an injunction pending appeal. The motion was denied on June 21, 1967.

On June 13, 1967, Beaman moved to dismiss the action on various grounds, principally res judicata and collateral estoppel arising from the State court judgment and laches. The motion was argued on July 25, 1967, at which time the court stated it would grant the motion (R.T. 38-39) and directed counsel to prepare findings and judgment. The injunctive relief sought by Sackett having become moot when the State court judgment was satisfied (R.T. 50-51), Sackett sought, on August 3, 1967, to modify the proposed findings, conclusions and judgment so as to permit the filing of an amended complaint for damages. After oral argument on that date, the court below denied Sackett the right to amend and entered judgment dismissing Sackett's suit with prejudice.

STATUTES AND REGULATIONS INVOLVED

1. 15 U.S.C. 78j.

2. 15 U.S.C. 77q.

3. Securities and Exchange Commission Rule 10b-5.

SPECIFICATION OF ERRORS RELIED ON

1. The District Court erred in holding that plaintiffs' damage claim was barred by the statute of limitations.

2. The District Court erred in holding plaintiffs' claims were barred by res judicata and collateral estoppel.

QUESTIONS PRESENTED

1. Whether the defrauded buyer of securities can be deprived of his Federal remedy by a State action brought against him by the seller.

2. Whether the statute of limitations governing a damage action under Federal securities laws can be applied to deprive a defrauded buyer of securities of his Federal remedy while he is litigating the validity of his rescission of the sales contract in a State action.

ARGUMENT

I. THE DISTRICT COURT ERRED BY REFUSING PLAINTIFFS LEAVE TO AMEND THEIR COMPLAINT TO STATE THEIR CLAIMS FOR DAMAGES.

A. The failure of the District Court to grant plaintiffs leave to amend their complaint constitutes reversible error.

At or near the time of the judgment below, Fidelity and Deposit Company of Maryland (which had bonded Sackett's State court appeal) paid Beaman over $18,000.00 in satisfaction of the State court judgment. This entitled Fidelity to reimburse itself in a like

amount from collateral which Sackett had posted with it in June of 1965. With satisfaction of the State court judgment, Sackett's effort to obtain a Federal injunction against its enforcement became moot. Sackett accordingly sought leave to amend his complaint to claim his damages. See Plaintiffs' Proposed Modifications to Form of Judgment and to Findings of Fact and Conclusions of Law (C.T. 238-254). The court below, at a hearing on August 3, 1967, refused to permit the amendment (R.T. 42-55). The court said:

> "I can't see how you could find, on a claim of statute of limitations, anything that would be any different than that which would produce a finding of laches." (R.T. 46)

The court suggested that Sackett file another complaint for damages, but conceded that such a complaint would be barred by res judicata or collateral estoppel resulting from the judgment about to be rendered by the court below (R.T. 47).

The failure to give plaintiffs the opportunity to amend their complaint constitutes reversible error. *Cohen v. Gensbro Hotel Co.* (9th Cir. 1958) 259 F.2d 78.

B. The District Court erred in holding that plaintiffs' claims for damages were barred by the statute of limitations.

(1) Even if a State statute of limitations were applicable, plaintiffs' cause of action for damages could not have accrued over three years ago.

The following contentions are founded on the assumption, *arguendo,* that the California statute of limitations governing fraud claims (Code of Civil

Procedure Section 338(4)) is applicable to plaintiffs' claim for damages under Federal securities laws. This, however, is not conceded.

California statute provides that the various periods prescribed for commencing actions are to be computed from accrual of the cause of action. California Code of Civil Procedure § 312.[2] The central question, therefore, is when Sackett's cause of action for damages accrued.

The general rule in California is that a cause of action accrues when "under the substantive law, the wrongful act is done and *the obligation or liability arises,* i.e., when a suit may be brought." Witkin, *California Procedure,* p. 614.

Under the plain language of 15 U.S.C. § 77q[3] a violation occurs whenever a party obtains money or property by means of a prohibited statement or omission to state. Thus, in August 1967, when Beaman obtained the sum of $18,733.71 (by means of the untrue financial statement and by means of an omission

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[2]"Civil actions, without exception, can only be commenced within the periods prescribed in this title, *after the cause of action shall have accrued,* unless where, in special cases, a different limitation is prescribed by statute." (Emphasis added.)

[3]Section 17a of the Federal Securities Act of 1933 (15 U.S.C. §77q) provides in pertinent part:

> "(a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means of instruments of transportation or communication in interstate commerce or by use of the mails, directly or indirectly . . . (2) *to obtain money or property* by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading." (Emphasis added.)

to state material facts) a cause of action for damages arose.[4]

The court below ignored the fact that obtaining money or property by means of a violation of the Federal securities laws is unlawful even though the statutory violator makes use of a State court to accomplish his design (R.T. 49-50). The violation of a Federal statute cannot be legitimated by the judgment of a State court which not only failed to consider the Federal questions but (insofar as the Securities Exchange Act of 1934 is concerned) was totally lacking in jurisdiction to do so. The court in *Key Broadcasting System, Inc. v. Griffith* (1953) 119 N.Y.S.2d 174 applied this principle in a similar situation.[5]

Sackett's cause of action for damages under the Securities Exchange Act of 1934 (15 U.S.C. § 78j) and Rule 10b-5 likewise did not accrue until the fact of

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[4]It is not necessary to decide whether the entry of judgment in the State court action in May 1965, or the finality of that judgment in May 1967, would constitute separate violations. Claims made on those theories would also be timely, since both events occurred within the last three years.

[5]In that case, the seller sued to recover on a contract for the purchase of securities. The buyer defended on the ground that the contract was a violation of the Securities Act of 1933. The seller argued that this defense was not available because the buyer would be barred by the statute of limitations from bringing an affirmative action under the provisions of the Act on which his defense was based. The court held that the statute was not a bar in this situation and stated:

> "To construe it to so apply would lead to the anomalous situation wherein the statutory wrongdoer would be allowed to recover, because the one or three year limitation, as the case may be, had run, and then the wronged party would have one year to sue to get the consideration back, *although it was paid under a judgment.*" (At 175-176. Emphasis added.)

damage was definitely established, which was not before May 1965. For "uncertainty as to the fact of damage . . . negatives the existence of a cause of action." *Walker v. Pacific Indemnity Co.* (1960) 183 C.A.2d 513. In that case the court said:

> It is clear that mere possibility, or even probability, that an event causing damage will result from a wrongful act does not render the act actionable (*Pacific Pine Lumber Co. v. Western Union Telegraph Co., supra,* 123 Cal. 428; *McQuilkin v. Postal Tel. Cable Co.,* 27 Cal.App. 698, 703 [151 P. 21]; and see *McGregor v. Wright,* 117 Cal. App. 186, 196-197 [3 P.2d 624]). Of course, it is uncertainty as to the fact of damage, rather than its amount, which negatives the existence of a cause of action (*Allen v. Gardner,* 126 Cal.App.2d 335, 340 [272 P.2d 99]; *Milton v. Hudson Sales Corp.,* 152 Cal.App.2d 418, 434 [313 P.2d 936]). In the case at bar, the fact of any damage at all was completely uncertain until judgment in the personal injury action.
>
> Also significant are decisions holding that, in specific situations where the existence of actual loss is determinable only by judgment, the statute of limitations is tolled at least for the period required for determination on appeal (*County of Santa Clara v. Hayes Co.,* 43 Cal.2d 615 [275 P.2d 456]; *Burns v. Massachusetts etc. Ins. Co.,* 62 Cal. App.2d 962 [146 P.2d 24]; *Archer v. Edwards,* 19 Cal.App.2d 253 [65 P.2d 115]). (At 517)

See also,

Witkin, *California Procedure,* 1965 Supp., p. 265.

Thus, a damage claim based on fraud does not accrue until damages are definitely sustained. *Agnew v. Parks* (1959) 172 C.A.2d 756, 768 where the court said:

> "It is the rule that fraud without damage is not actionable . . . and one is not entitled to any relief thereon unless damage is alleged and proved."

The record establishes that Sackett unilaterally rescinded the contract in December 1961 shortly after discovery of the misrepresentations by Beaman. Under California law, such a unilateral rescission is effective without judicial action. California Civil Code §§ 1688, 1691-92. Witkin, *Summary of California Law,* 1965 Supp., pp. 84 et seq. The rescission was therefore effective from December of 1961 until May of 1965 when the Superior Court ruled that it was invalid. In the interim Sackett could neither allege nor prove that he had been damaged.

In summary, Sackett's cause of action for damages under 15 U.S.C. §77q accrued when Beaman obtained money, which did not occur until August 1967. Likewise, Sackett's cause of action under 15 U.S.C. §78j and Rule 10b-5 did not accrue until he sustained definite damage. This did not occur until May 1965 when his rescission was adjudged invalid by the State court. Hence Sackett's damage claims cannot be time-barred until May 1968.

(2) Even if the State statute of limitations were applicable and even if plaintiffs' cause of action had accrued in 1961, the statute of limitations was suspended during pendency of the State action.

During the pendency of the State court action, Sackett was effectively prevented from suing for damages under Federal securities laws. In the first place, as pointed out above, he could not have either alleged or proved the existence of damage attributable to Beaman's misrepresentations until May 1965 when the State court entered judgment. In the second place, Sackett was bound by the election of remedies doctrine under California law. Under this doctrine it has always been the rule in California that a litigant must choose between affirmance of a contract coupled with a suit for damages, on the one hand, and disaffirmance of the contract and suit for restitution, on the other.[6] As has been noted above, Sackett promptly on discovery of the misrepresentation chose the latter course.

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[6] *Paularena v. Superior Court* (1965) 231 C.A.2d 906, 915:

> The remedy based upon the existence of the contract to purchase is inconsistent with the remedy based upon its nonexistence. (*Davis v. Rite-Lite Sales Co.*, 8 Cal.2d 675, 678-679 (67 P.2d 1039); *Lenard v. Edmonds, supra*, 151 Cal. App. 2d 765, 768.) Damages may not be recovered on the theory that the contract exists and additionally on the theory that the contract is at an end.

Jozovich v. Central Calif. B. G. Assn. (1960) 183 C.A.2d 216, 228-229:

> The cases have recognized the common-sense rule that an aggrieved party may not simultaneously pursue inconsistent procedures for relief. In the case of breach of contract he may treat the agreement as alive and effective, suing for damages for breach, or he may assume the contract dead and proceed to obtain restitution. But damages and restitution constitute alternative remedies and an election to pursue one is a bar to invoking the other. (*Alder v. Drudis* (1947) 30 Cal.2d 372 (182 P.2d 195); 12 Cal.Jur.2d, Contracts, p. 491, sec. 260.)

He gave prompt written notice of rescission pursuant to California statutes. When he was subsequently sued by Beaman in the State court, he defended on the basis of his rescission and cross-complained for restitution of the $1,000.00 which he had paid. Under these circumstances, Sackett could not at any time prior to May of 1965 have placed himself in a contrary position in a Federal suit without thereby ruining his defense in the State court. Such a Federal suit prior to May of 1965 would have been used as evidence in the State court that Sackett had abandoned his claim that the contract had been rescinded. *Dolinar v. Pedone* (1944) 63 C.A.2d 169, 146 P.2d 237 (pleading may be offered as an evidentiary admission against the pleader in another case).

The situation calls for application of the California rule that the statute of limitations is suspended during any period when pending legal proceedings prevent an effective suit. This principle is explained in Witkin, *California Procedure,* pp. 674-675, and has been enunciated and applied in a long line of California decisions.

Lerner v. Los Angeles City Board of Education (1963) 59 C.2d 382, 391, 29 Cal.Rptr. 657, 380 P.2d 97;

Santa Clara v. Hayes Co. (1954) 43 C.2d 615, 618, 275 P.2d 456;

Skaggs v. City of Los Angeles (1954) 43 C.2d 497, 500, 275 P.2d 9;

Dillon v. Board of Pension Commrs. (1941) 18 C.2d 427, 431, 116 P.2d 37;

Lee C. Hess Co. v. City of Susanville (1959) 176 C.A.2d 594, 1 Cal. Rptr. 586;
Van Hook v. So. Cal. Waiters Alliance (1958) 158 C.A.2d 556, 565, 323 P.2d 212;
Christin v. Superior Court (1937) 9 C.2d 526, 530, 71 P.2d 205.

(3) In any event a Federal court is not bound to apply a State statute of limitations to defeat the assertion of Federal rights.

The parties are in agreement that there is no Federal statute of limitations applicable to the case at bar. While the Federal courts under such circumstances have frequently applied the analogous State statute of limitations, they will refuse to do so where in a proper case it would defeat the assertion of Federal rights. Thus, in *Fischbach & Moore, Inc. v. Int'l Union* (S.D. Cal. 1961) 198 F.Supp. 911, 914-915, the court, after reviewing a case involving the Fair Labor Standards Act, stated:

> The reasoning of the Davis case is clearly applicable to the case at bar. Like the Fair Labor Standards Act, the Labor Management Relations Act is a statute relating to interstate commerce. Similarly, the statute is a matter of national concern and it has been recognized by the Supreme Court that the purposes underlying the Labor Management Relations Act imply a policy of uniform application of the statute to all persons subject thereto. Further, the prohibitions of the Act would be set at naught and its benefits denied to the plaintiffs herein if the California statute of limitations were applied. Finally, the plaintiffs in this action would receive treatment unequal to

> that accorded more fortunate plaintiffs in other states having longer limitations periods, if California Code of Civil Procedure, § 338, subd. 1 were utilized by this court. For all these reasons, the court declines to so act.

All these considerations are equally applicable to the Securities Act of 1933 and the Securities Exchange Act of 1934.

C. Unless plaintiffs are permitted to present their damage claims in the present proceeding they will be denied a hearing on their Federal claims.

The court below dismissed Sackett's equitable claims primarily on the ground of laches. In arriving at this conclusion the court erroneously stated that any claim for damages was barred three years after the discovery of the misrepresentations of Beaman, i.e. three years after December 1961. From this conclusion the court reasoned that it was proper by reference to the statute of limitations to conclude that laches would bar an equity suit.

This approach of the court, as well as the court's explicit language,[7] makes it clear that the ruling intended to foreclose any further action of any kind by Sackett arising out of the sales contract. Sackett would thus be met in any subsequent action for damages with the contention that the decision below precluded such

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[7]The court said:

> "It seems to me that this (the judgment below) has the effect of cutting you off at the pockets completely, regardless of how I word it, for damages or equitable relief or anything else. * * * On the theory I have adopted . . . you couldn't state a cause of action for damages which wouldn't be vulnerable to a claim of untimeliness." (R.T. 45-46)

further action on principles of res judicata and collateral estoppel. That problem makes the present appeal crucial. Absent a reversal on the issue of the right to amend, Sackett's Federal rights created by Congress and entrusted exclusively to the Federal courts will have been completely destroyed.

II. THE DISTRICT COURT ERRED IN HOLDING PLAINTIFFS' CLAIMS WERE BARRED BY RES JUDICATA AND COLLATERAL ESTOPPEL.

A. Plaintiffs did not litigate their Federal claims in the State court action.

Sackett's defense in the State court was confined to his unilateral rescission (based on fraud, failure of consideration and mistake under California law). His only affirmative action in the State court was his corresponding claim for restitution of the $1,000.00 he had paid Beaman. This is established by the following documents constituting part of the file in Action Number 518296 in the Superior Court of the State of California for the City and County of San Francisco:

1. Judgment (copy attached to Declaration of Rudolph J. Scholz dated May 8, 1967, C.T. 22-23).

2. Amended Answer and Cross-Complaint (copy attached to aforesaid Declaration, C.T. 31-39).

3. Findings of Fact and Conclusions of Law (copy attached to aforesaid Declaration, C.T. 24-30).

4. Complaint (copy attached to Affidavit of Nathan S. Smith dated May 18, 1967, C.T. 80-83).

In none of the foregoing documents is there any mention made of any violation of the Securities Act of 1933 or the Securities Exchange Act of 1934. Therefore, it is beyond dispute that the Federal claims presented to the court below were reserved throughout the State court litigation. In this connection the United States Supreme Court has stated that an explicit reservation is not indispensable. The court said, "[T]he litigant is in no event to be denied his right to return to the District Court unless it clearly appears that he . . . fully litigated his Federal claims in the State Courts." *England v. Louisiana Medical Examiners* (1964) 375 U.S. 411, 421.

B. The right to litigate Federal claims in Federal court is absolute.

Even where Federal jurisdiction is not exclusive, parties have an absolute right to litigate their Federal questions in Federal court. *England, supra.* In that case, an attack on a Louisiana statute on Federal constitutional grounds was presented in the Federal court. The Federal court abstained pending a decision by the Louisiana courts as to the applicability of the statute. The Federal plaintiffs, having lost their case in the Louisiana courts, returned to the District Court for a determination of their constitutional claim. The United States Supreme Court held that a party cannot be forced to litigate his Federal claims in a State court. Only one limitation is imposed—the right may be lost if the Federal claim is voluntarily submitted to and fully litigated in the State court.

This limitation has no application in the case at bar because plaintiffs did not litigate their Federal claims in the State court. Furthermore, plaintiffs here were initially brought involuntarily into State court by virtue of Beaman's suit against them. Beaman's counsel have conceded that Sackett never had any right to remove the State case to Federal court. R.T. 18-19.

We cannot state our essential argument any better than was done by Mr. Justice Brennan in *England, supra,* at 415:

> "There are fundamental objections to any conclusion that a litigant who has properly invoked the jurisdiction of a Federal District Court to consider federal constitutional claims can be compelled, without his consent and through no fault of his own, to accept instead a state court's determination of those claims. . . . Such a result would be at war with the unqualified terms in which Congress, pursuant to constitutional authorization, has conferred specific categories of jurisdiction upon the federal courts, and with the principle that 'When a Federal court is properly appealed to in a case over which it has by law jurisdiction, it is its duty to take such jurisdiction * * *. The right of a party plaintiff to choose a Federal court where there is a choice cannot be properly denied.' "

Justice Brennan went on to note that access to the Federal court at the trial level is of great importance and its absence cannot be justified by the existence of the right of review in the United States Supreme

Court of a final judgment of a State court. He said that such review is "an inadequate substitute for the initial District Court determination."

> "This is true as to issues of law; it is especially true as to issues of fact. Limiting the litigant to review here would deny him the benefit of a federal trial court's role in constructing a record and making fact findings. How the facts are found will often dictate the decision of federal claims." (At 416.)

These principles apply forcefully in the case at bar. The plaintiffs here were doomed insofar as the State court relief is concerned by the finding of the trial court in May of 1965 that the now conceded falsity of the financial statement on which plaintiffs relied was not material. (See State Court Findings of Fact and Conclusions of Law, Findings Nos. 13(a) and 13(b), C.T. 29.) Appellate review in the California courts was ineffective largely because the California Court of Appeal thought that there was evidence which to some extent supported the trial court's conclusion. Thus plaintiffs here have since May of 1965 been "encased" by a State court finding.[8] In such a situation their right to present their Federal claims in Federal court is of the utmost importance.

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[8]"A litigant trapped in State Court proceedings may find himself veritably encased by findings of fact which no appellate court may disturb.' *England, supra*, at p. 436.

C. Principles of res judicata do not override the principles of England v. Louisiana State Board.

Congress provided that the Federal courts shall have exclusive jurisdiction of violations of the Securities Exchange Act of 1934. 15 U.S.C. 78aa. If, as the court below indicated, plaintiffs are barred by principles of res judicata or collateral estoppel, then it is apparent that the effort of Congress to provide a Federal forum for such questions can be completely defeated in any case where a fraudulent seller of stock brings prompt suit in the State court. By so doing, he can force the defrauded party into the position of the plaintiffs in the case at bar. They will be helpless to remove the State court action, and if unsuccessful in the State courts, will be barred from subsequent access to Federal courts by the doctrines erroneously applied by the court below.

The applicability of res judicata so as to defeat Federal jurisdiction was considered and rejected in the *England* case.

Justice Douglas, there considering the possible effect of res judicata on the right of a party to litigate his Federal claims in a Federal court, stated: "But res judicata is not a constitutional principle; it has no higher dignity than the principle we announce today." 375 U.S. 411 at 429.

In the court below, Beaman placed his principal reliance on the case of *Connelly v. Balkwell* (D.C. N.D. Ohio 1959) 174 F.Supp. 49, aff'd (6th Cir. 1960) 279 F.2d 685, which was decided four years prior

to *England*. Insofar as *Connelly* may imply that a party may by consent endow a State court with jurisdiction over Federal questions committed by Congress to the exclusive jurisdiction of the Federal courts, it is clearly erroneous. Insofar as the result reached in *Connelly* may be justified on the ground that the plaintiff there voluntarily chose the State court before presenting his Federal question in Federal Court, it has no application in the case at bar. For, as we have said, plaintiffs here did not select the State forum, but were forced there by Beaman's action.

III. IN ANY EVENT A STATE COURT JUDGMENT CANNOT DEPRIVE A FEDERAL COURT OF THE EXCLUSIVE JURISDICTION GRANTED IT BY CONGRESS.

Congress granted to the Federal courts exclusive jurisdiction over violations of the Securities Exchange Act of 1934:

> "The district courts of the United States, and the United States courts of any Territory or other place subject to the jurisdiction of the United States, shall have exclusive jurisdiction of violations of this chapter or the rules and regulations thereunder, and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter or the rules and regulations thereunder." 15 U.S.C. 78aa.

In view of this, the Federal courts cannot be bound by any State court determination directly or indirectly affecting a violation of the Securities Exchange Act

of 1934. This is made clear by *Restatement of Judgments,* Section 71, which reads as follows:

> "Where a court has incidentally determined a matter which it would have had no jurisdiction to determine in an action brought directly to determine it, the judgment is not conclusive in a subsequent action brought to determine the matter directly."

The example cited in Comment c of Section 71 precludes any doubt in this regard:

> "The rule stated in this Section is applicable where a State Court has incidentally determined a matter which the federal courts alone have jurisdiction to determine directly.
>
> If an action is brought in a State Court on a promissory note, and the defendant in his answer alleges that the note was given for a void patent, the decision of the court that the patent was or was not void is not binding in a subsequent action brought in a federal court to have the patent declared void, or to enjoin an infringement of the patent, although the subsequent action is between the same parties, since the federal courts have exclusive jurisdiction to set aside a patent or entertain a suit for its infringement."

The case at bar is even more clear, for the Federal questions, as shown above, were not even incidentally determined by the State court.

CONCLUSION

For the reasons stated, it is respectfully submitted that the District Court's judgment of dismissal with prejudice and order denying plaintiffs leave to amend their complaint to state a claim for damages be reversed, and the cause remanded with instructions to vacate said judgment and to grant plaintiffs leave to file an amended complaint.

NATHAN S. SMITH,
JAMES G. SEELY, JR.,
Attorneys for Appellants.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18, 19 and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

NATHAN S. SMITH,
Attorney for Appellants.